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ABSTRACT

This lesson on developing a business plan, the third in a series of 18 units, is part of the first level of a comprehensive entrepreneurship curriculum entitled: A Program for Acquiring Competence in Entrepreneurship (PACE). (Designed for use with secondary students, the first level of PACE introduces students to the concepts involved in entrepreneurship and helps them become aware of entrepreneurship as a career option.) The following topics are covered in the unit: identifying the reasons for planning for entrepreneurship; identifying the components of a business plan (marketing, organizational, and financial plans); and completing a business plan worksheet. Included in the lesson are instructional text organized in a question-and-answer format, group and individual learning activities, and assessment questions. (MN)

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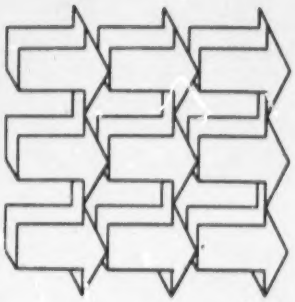

UNIT 3

- [x] Level 1
- [ ] Level 2
- [ ] Level 3

Developing the Business Plan

Developed by M. Catherine Ashmore and Sandra G. Pritz

You will be able to:

- **Identify the reasons for planning for entrepreneurship.**
- **Identify the components of a business plan.**
- **Complete a business plan worksheet.**

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BEFORE YOU BEGIN. . .

1. Consult the *Resource Guide* for instructions if this is your first PACE unit.
2. Read the Unit Objectives on the front cover. If you think you can meet these objectives now, consult your instructor.
3. Look for these business terms as you read this unit. If you need help with their meanings, turn to the Glossary in the *Resource Guide*.

business plan
cost of goods sold
entrepreneur
gross margin
income statement
inventory
net profit
operating expenses
sales

DEVELOPING THE BUSINESS PLAN

WHAT IS THIS UNIT ABOUT?

This unit introduces you to the Business Plan—a very important document to you as a would-be entrepreneur. The Business Plan is required by most agencies or individuals who might be considering investing or lending you money for your proposed business. And it is absolutely necessary to help future small business owners plan on paper whether a proposed business is likely to be profitable.

You will learn in some detail why the Business Plan is so important. You will examine the parts of a Business Plan by reviewing the activities of a group of young people as they plan to set up their own simple business.

You will have the chance to check your learning through applying a case study situation to a Business Plan Worksheet provided by the Small Business Administration. The unit contains a short test (assessment) for your use to see how well you understand the unit.

Actually, this is a key unit because all of the other units in the PACE series focus on the preparation of a Business Plan. The information that you collect or develop in the other units all help you develop a Business Plan if you decide to open your own business.

WHY DEVELOP A BUSINESS PLAN?

The Business Plan is a roadmap to owning and operating a small business. As the future owner/manager of a new business, you must work out the details of every part of the proposed company. You need to collect information carefully and put your findings on paper. After you have prepared the Business Plan, you will be able to find out whether you will be able to make a profit and when this is likely to happen. Or you will see the need for changes that can be made on paper before the business opens and before you make costly mistakes.

The Business Plan is very important if you need to borrow money or seek investors to get your business going. Bankers, loan agencies, or individual persons will want to study your plan to see if your business promises to be profitable. Only then will they consider loaning you money or investing in your company.

The Business Plan will also give you a guide to follow in managing your business after you open, for the Business Plan requires you to plan every aspect of operating the business.

WHO DEVELOPS THE BUSINESS PLAN?

Do you remember running a lemonade stand in your neighborhood when you were a kid? Most of us recall a time when we were caught up in the excitement of organizing our own little "business." Maybe your project involved joining with your playmates and giving a play or variety show for your parents or friends. Or perhaps you and other young friends prepared a neighborhood newsletter, or collected old clothes and had a rummage sale, or sold Girl Scout cookies. All of these "businesses" were forms of entrepreneurship. Although the "play" projects produced the side benefits of fun and learning to work together, you were probably inspired by the chance to put your talents to work to "make some money."

You see, your fund-raising project was a small marketing business that sold goods (lemonade, old clothes, cookies) or services (variety show, newsletter) to customers (parents, relatives, neighbors) for a profit (the money left after you paid your expenses). And you were an *entrepreneur*—a person who invests money, energy, and time in a business in hopes of making money. As an entrepreneur or prospective owner/manager, you are responsible for developing the Business Plan for the business that you want to open.

WHAT'S IN A BUSINESS PLAN?

Let's identify the parts of a Business Plan by reviewing the activities involved in setting up a lemonade stand in Jonathan Spivey's front yard on a hot June day. What Jonathan and his friends did to get the business going are what every entrepreneur should do before opening a new business. The difference is that Jonathan's business is a simple one, and that fact should make this business planning process easier to understand. The activities of Jonathan and his friends show the different parts of a Business Plan.

Three enterprising youngsters were very hot and thirsty. They thought that other people were probably also thirsty for an ice-cold, refreshing glass of lemonade. Maybe the other people would be willing to buy the lemonade from them.

The three friends were Jonathan Spivey, Kathy Merritt, and Joey Wiltshire. Here is their story, told as the parts of a Business Plan.

PART ONE: DESCRIPTION OF THE BUSINESS

WHAT PRODUCT OR SERVICE SHALL WE SELL?

As Jonathan and his friends drank the lemonade that Jonathan's mother made for them, Jonathan said, "Hey, you guys, why don't we get some paper cups and sell this stuff out front under the big oak tree? I'll bet we could make some money."

And that was the marketable idea that launched a business planning venture in Centreville, U.S.A. They decided that their business would sell lemonade.

PART TWO: MARKETING PLAN

WHAT IS OUR PLAN FOR MARKETING?

The three young entrepreneurs probably didn't know that they were developing a marketing strategy (or plan) to get people to buy their product. But that is exactly what they did as they decided—

- **Who will buy our product?**

  All the hot, thirsty people who see our business under a cool shade tree. All the passersby who remember their own lemonade stands and want to give us kids a boost.

- **Where should we locate our business?**

  The large oak tree stands near a busy intersection, so traffic from two directions will see our stand.

  There is plenty of parking space on both streets for customers to stop without danger.

  The nice shade will be inviting on a hot day.

- **How can we attract customers?**

  We'll need a name for our company. Why don't we call it "LEMON-AID?" We know how to spell lemonade, but we want to catch the customers' eye.

  We need a sign on both streets. We need a sign high enough on the oak tree to be seen over traffic. We need chairs for customers to sit in while they drink.

We need a sign on the lemonade stand. Then we need to get a large box and paint it yellow and pink. This will be our building. Our advertising signs will say:

1. BUY YELLOW AND PINK "LEMON-AID" FROM THE KIDS

2. TAKE HOME A GALLON OF "LEMON-AID" FOR THE FAMILY

- **What is the competition?**

  The nearest soft drink place is the service station four blocks down Falkner Avenue. And they don't have any shade, or any homemade lemonade in two colors, or any cute kids selling it.

- **What advice do we need?**

  No one should open a business without seeking advice from experienced people, who can help us make our important decisions.

  Let's talk to our parents and ask their opinions about our product and our proposed location.

PART THREE: ORGANIZATION PLAN

HOW SHALL WE ORGANIZE?

We will organize our business as a general partnership. All three of us will contribute money and work. We will make all decisions together and we will split the profits at the end. We are equally responsible for any losses.

PART FOUR: THE FINANCIAL PLAN

WILL WE MAKE A PROFIT?

Their parents were interested in learning more about the LEMON-AID project. Jonathan's parents offered space in their refrigerator to store a gallon jug of lemonade. Joey's parents offered to lend them folding chairs. They also offered a styrofoam chest for storing ice and lemonade near the stand. But the parents wanted more information about the company's finances. They realized that they would probably be asked to become investors, and they wanted their children to learn from the experience.

Kathy's father offered to help them develop the financial plan. Such a plan would help them figure out in advance how much *net profit* (money left after all expenses have been paid) they would have at the end of the summer. With Mr. Merritt as financial consultant, they estimated how much profit the business might be able to make.

Investors in a business want to know the answers to two major questions answered in the financial section:

- How much profit can the business make?
- How much money do you need to get the business started and to keep it going until you make a profit?

Decisions about the first question are made by studying a Projected Income Statement for the business. The *income statement* shows all the business transactions for a firm over a specified period of time (a month, a quarter, a year). The statement shows the company's profit (or loss) during the period. A Projected Income Statement estimates how profitable a business will be.

A new business should not be opened unless the Projected Income Statement shows a profitable business by the end of the first year. If your first statement fails to show a profit, you must expand sales or reduce expenses. Most entrepreneurs make two Projected Income Statements. One statement is based on the expected level of sales, and the other is based on a more conservative estimate. A sample of a Projected Income Statement is shown on the next page.

Kathy's father shared the formulas below to help the LEMON-AID group estimate their profit (or loss) for the two months that the business would operate:

- Estimated Sales - Cost of Goods Sold = Gross Profit
- Gross Profit - Operating Expenses = Net Profit

Mr. Merritt guided the LEMON-AID partners through each step of the formulas. His method was to ask them questions about their plans. The following sections show the process used to determine how much profit the business would make.

Estimated Sales. The *sales* figure is all the money that customers are expected to spend on your business during the period covered by the income statement.

Question: How many customers do you expect to attract during the two months? How much will they buy?

Answer: We will count on an average of 10 customers an hour.
We will be open 6 hours a day for 40 days. If we serve 6-ounce cups, the customers will buy 2 gallons of lemonade a day (60 customers × 6 oz. = 360 oz. 128 oz. per gal. = 2.03 gallons).
We expect to sell 3 gallons of lemonade in bulk (whole gallons at one time) during the two months.

ANNUAL PROJECTED INCOME STATEMENT
PANTS-AT-A-PRICE (William Sandolo)
September 1, 19 - -, through August 31, 19 - -

Sales		$141,.[illegible]0
Beginning Inventory	$43,375	
Inventory Purchased	79,947	
Less: Ending Inventory	43,222	
Cost of Goods Sold		$ 79,100
Gross Profit		$ 62,150
Less: Operating Expenses		
Rent	$ 7,063	
Depreciation	2,825	
Repairs	1,836	
Salaries and wages	16,102	
Payroll taxes and fringe benefits	2,119	
Taxes, license, fees	2,119	
Insurance	1,555	
Legal and accounting fees	848	
Bad debts	2,825	
Telephone	381	
Utilities	2,260	
Supplies	423	
Security	1,357	
Advertising and promotion	4,238	
Interest	849	
Postage and freight	849	
Travel	1,128	
Dues and subscriptions	143	
Bank service charge (credit cards)	2,403	
Other credit card fees	706	
Miscellaneous (fixed and variable)	2,993	
Total expenses		$ 55,022
Net Profit before Taxes		$ 7,128
Federal Income Taxes (corporation only)		$ —
Net Profit		$ 7,128

SOURCE: Ely, Viven, K., and Barnes, Michael T. *Starting Your Own Marketing Business*, 2nd ed. New York: McGraw-Hill Book Company, 1978.

Question: How much will it cost to make that amount of lemonade?

Answer: We asked Jonathan's mother for the lemonade recipe. We shopped around at grocery stores for the best prices. We found it will cost $6.21 to make and serve a gallon of lemonade.

24 lemons @ $.20 ea.	$4.80
1 lb. sugar @ $.30	.30
21 6-oz. cups @ $.05	1.05
food coloring and napkin	.03
1/2 lb. ice @ $.06 lb.	.03
	$6.21

Question: How much will you need to charge for lemonade?

Answer: It will cost $.387 (almost 39 cents) to make a 6-ounce cup of lemonade ($6.21 16 cups per gallon = $.387 per cup).

We checked competitors' prices. Soft drinks at the service station cost 45 cents for 12 ounces. The local drug store fountain charges 55 cents for 8 ounces of lemonade.

We had hoped to charge 25 cents for a 6-ounce cup. Obviously, if it costs almost 39 cents to make a cup, then we will have to add enough to cover expenses and make a profit. We really doubt if 50 cents per cup is enough to produce a profit, but our advisors think that most customers will not pay more.

Question: What will your sales volume be at a selling price of 50 cents per cup?

Answer: We estimate our total sales volume for the two months to be $664.00.

32 c. per day × 40 days ×	
$.50 per cup =	$640.00
3 gal. @ 8.00	$ 24.00
Estimated sales	$664.00

Cost of Goods Sold. Mr. Merritt explained that *cost of goods sold* is the term for the cost of the goods that are actually sold during an income statement period. The calculation is made as follows:

> dollar value of beginning inventory + dollar amount of purchases - dollar value of ending inventory = cost of goods sold

Inventory refers to the materials purchased by a business to produce goods or services, or it can mean the finished goods purchased for resale to customers.

Since the LEMON-AID business will exist for only two months, we can figure "cost of goods sold" by estimating how much they would spend for lemonade ingredients and paper cups during that time.

Question: How much will the "goods" you sell cost you?

Answer: We will spend $515.43 for "goods sold."

83 gallons × $6.21 per gallon = $515.43
Cost of goods sold = $515.43

Gross Profit. Gross profit is also called *gross margin.* This is all the money you make from sales before you subtract any operating expenses. Mr. Merritt explained that gross profit is figured by subtracting the cost-of-goods-sold figure from the estimated sales figure.

Question: What is your gross profit?

Answer: Our gross profit will be $148.57.

Estimated sales	$664.00
Cost of goods sold	515.43
Gross profit	$148.57

At this point, the LEMON-AID partners became worried about whether it was worth continuing with the project. Mr. Merritt insisted that they complete the Projected Income Statement before deciding, so they continued.

Operating Expenses. *Operating expenses* summarize the amounts paid out to keep the business running. Mr. Merritt told the LEMON-AID group to look at the Projected Income Statement (p.) for examples of operating expenses.

Question: How much will your operating expenses be?

Answer: We planned to pay a small wage to the person working the stand (25 cents per hour).
We will need to replace our advertising posters once during the two months.

Salaries and wages, 240 hours @ $.25 (40 days × 6 hours × $.25 per hour = $60.00	$60.00
Advertising and promotion (4 sheets poster board @ $.60)	$ 2.40
Operating Expenses	$62.40

Net Profit. Now the LEMON AID entrepreneurs had arrived at the "bottom line"—the net profit figure.

Question: How much is your net profit?

Answer: After subtracting the operating expenses from the gross profit, we have $86.17 net profit to divide among the three of us.

Gross profit	$148.57
Operating expenses	62.40
Net profit	$ 86.17

The Projected Income Statement that Jonathan, Kathy, and Joey prepared for their parents is shown below.

PROJECTED INCOME STATEMENT
for "LEMON-AID"
(Jonathan Spivey, Kathy Merritt, Joey Wiltshire)
July 1, 1982 through August 31, 1982

Sales	$664.00
Less: Cost of goods sold	515.43
Gross profit	$148.57
Less: Operating expenses	62.40
Net profit	$ 86.17

The would-be LEMON-AID owners realized that the business would not be profitable enough for them to find investors. Even if they decided to eliminate the modest wages for themselves ($60.00), their net profit would increase to only $148.57. They decided not to start the LEMON-AID business without completing the other parts of the Business Plan.

The business planning experience was helpful for Jonathan, Kathy, and Joey, for they learned an important lesson in entrepreneurship. The Business Plan helps the entrepreneur answer two major financial questions in advance:

- How much profit does the business promise to make?
- How much money do I need to get started and to keep the business going until it makes a profit?

ACTIVITIES

Now that you are familiar with the reasons for developing a Business Plan and have learned what a Business Plan includes, try this activity.

Small Marketing Aid #150

- Using the Small Business Administration's *Business Plan for Retailers*, complete as much of the workbook as you can.
- Discuss your completed *Aid* with your teacher and class members. Compare your answers with the others and make changes or additions as the group decides.

ASSESSMENT

Directions: On a separate piece of paper, number from 1 to 16. Select the best answer for each of the statements below. Write the letter you select next to the number on your sheet of paper.

1. The primary reason for developing a Business Plan is—

   a. to determine whether the proposed business promises to be profitable.
   b. to provide records for federal income tax returns.
   c. to help entrepreneurs decide how to go about purchasing a franchise.

2. Lending agencies (like banks) review Business Plans—

   a. in order to open a new account for the proposed business.
   b. in order to provide a credit rating for the new business.
   c. in order to determine whether to lend money for a new business.

3. Once a Business Plan is completed—

   a. it is too late to make adjustments before the business opens.
   b. the business location is firm.
   c. changes are still possible on paper before the business opens.

4. A Projected Income Statement—

   a. estimates how profitable a business will be.
   b. identifies sources of investment money for your business.
   c. is a guide to follow in managing your business.

Complete the following statement by filling in the blanks (write your answers on your sheet of paper):

5. The financial part of a Business Plan answers two major questions:

   a.

   b.

Identify the parts of a Business Plan by matching the parts in the right-hand column below with the questions in the left-hand column. Place the correct letter from the right column on your sheet. The numbers of the questions should match the numbers on your sheet of paper. The parts may apply to several questions.

6. How shall we attract customers?	a. Marketable product or service
7. What shall we sell?	b. Marketing plan
8. What is the competition?	c. Financial plan
9. How much will it cost to get started	d. Organization plan
10. Is additional money needed?	
11. What will our expenses be?	
12. Who will buy our product or service?	
13. What will our sales volume be?	
14. Where shall we locate the business?	
15. Does the business promise to be profitable?	
16. What form of organization is best for us?	

NOTES

[1] Ely, Vivien K., and Barnes, Michael T. *Starting Your Own Marketing Business.* 2nd ed. New York: McGraw-Hill, Inc., 1978, p. 83.

We thank the above authors for permission to reprint from their work.

OTHER SOURCES USED TO DEVELOP THIS UNIT

Your teacher will provide you with the following resource materials needed in the LEARNING ACTIVITY:

U.S. Small Business Administration. *Business Plans for Retailers.* Small Marketer's Aid, No. 150. Washington, D.C.: U.S. Government Printing Office, 1978. Available free from field offices and Washington, D.C., headquarters of the SBA.

For further information, consult the lists of additional sources in the *Resource Guide*.

PACE

Unit 1. Understanding the Nature of Small Business

Unit 2. Determining Your Potential as an Entrepreneur

Unit 3. Developing the Business Plan

Unit 4. Obtaining Technical Assistance

Unit 5. Choosing the Type of Ownership

Unit 6. Planning the Marketing Strategy

Unit 7. Locating the Business

Unit 8. Financing the Business

Unit 9. Dealing with Legal Issues

Unit 10. Complying with Government Regulations

Unit 11. Managing the Business

Unit 12. Managing Human Resources

Unit 13. Promoting the Business

Unit 14. Managing Sales Efforts

Unit 15. Keeping the Business Records

Unit 16. Managing the Finances

Unit 17. Managing Customer Credit and Collections

Unit 18. Protecting the Business

Resource Guide

Instructors' Guide

Units on the above entrepreneurship topics are available at the following three levels:

- Level 1 helps you understand the creation and operation of a business
- Level 2 prepares you to plan for a business in your future
- Level 3 guides you in starting and managing your own business

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